EXPLANATORY MEMORANDUM TO

THE LOCAL GOVERNMENT PENSION SCHEME (AMENDMENT) REGULATIONS 2006

2006 No. 966

1. This explanatory memorandum has been prepared by the Office of the Deputy Prime Minister and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Select Committee on the Merits of Statutory Instruments.

2. Description

2.1 The Regulations amend the Local Government Pension Scheme Regulations 1997 (S.I. 1997/1612 - the "principal Regulations") with effect from 1st April 2006, 6th April 2006 and 1st October 2006 respectively. They remove the "85 year rule" (see paragraph 3.1) and make changes consequent on the simplification of the tax regime relating to pensions.

3. Matters of special interest to the Select Committee on the Merits of Statutory Instruments

3.1 As noted in paragraph 2.1, certain regulations come into force less than 21 days from the date of laying. The Committee will be aware of the controversial nature of some of the provisions made by the Regulations, in particular those which remove the so-called 85 year rule from the Local Government Pension Scheme. The 85 year rule currently allows members to retire and take their pension entitlements without actuarial reduction if the sum of their age and their length of service equals or exceeds 85 years. Members over 60 can do so as of right; members over 50 but under 60 require their employer's consent.

3.2 The amendments contained in these Regulations have been the subject of extensive consultation and discussion. Most recently, a statutory consultation on draft proposals closed on 28th February 2006. Discussions on the precise form of the amendments continued with representatives of the trade unions and the local government employers until very shortly before the Regulations were made.

3.3 As the Committee will also be aware, trade unions representing members of the Scheme balloted for industrial action over the proposed changes, and a national strike of local government employees took place on 28 March 2006.

3.4 In addition, UNISON, one of the interested trade unions has applied to the High Court for permission to seek judicial review of the consultation process and that application has not yet been determined by the Court.

3.5 To allow time for continuing discussions over the content of the Regulations, and in the light of the legal challenge, it was decided that they should be made as late as possible.

3.6 A number of the regulations address amendments to the Scheme that are necessary as a result of changes to the tax regime following the Finance Act 2004. These changes come into force on 6th April 2006.

3.7 Although section 12 of the Superannuation Act 1972 provides that regulations under section 7 of that Act may have effect as from a date earlier than the making of the regulations, and that accordingly these regulations could have been made some time later (so as not to breach the 21-day rule) but with retrospective effect, the view was taken that it was more appropriate to make them before the start of the tax year. It was also considered desirable, given the nature of the regulations, that they should be made and laid before Parliament rose.

3.8 . The Office of the Deputy Prime Minister apologises to the Committee for the fact that this has inevitably led to a breach of the 21-day rule.

4. Legislative Background

4.1 The principal Regulations are made under sections 7 and 12 of the Superannuation Act 1972; these amending Regulations (which do not contain any retrospective provisions) are made under section 7 alone.

5. Extent

5.1 This instrument applies to England and Wales.

6. European Convention on Human Rights

6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

7.1 Ministers have decided to proceed with regulations which comply with the statements made by the Minister for Local Government, Phil Woolas MP, to the House of Commons on 13 July and 2 December 2005 and most recently on 28 March 2006.

7.2 The 85 year rule was first removed from the Scheme with effect from 1st April 2005, by the Local Government Pension Scheme (Amendment) (No.2) Regulations 2004 (S.I. 2004/3372), which were subsequently revoked with retrospective effect by the Local Government Pension Scheme (Amendment) Regulations 2005 (S.I. 2005/1903). These Regulations remove the 85 year rule again, with effect from 1 October 2006. The removal of the rule is simultaneous with the commencement date of age discrimination legislation changes, implementing Council Directive 2000/78/EC, which establishes a general framework for equal treatment in employment and occupation.

7.3 Transitional arrangements are provided for those existing Scheme members who would have satisfied the rule by their 60th birthday before 31 March 2013. This provides protection for those scheme members closest to retirement who might have made financial assumptions based on the continuance of the 85 year rule and would not have sufficient time to make alternative arrangements. Further consideration may still be given to additional transitional protection arrangements for existing scheme members, where these are affordable and can be legally provided, in the context of a new-look Scheme for 2008.

7.4 As well as taking action to remove the rule of 85 these regulations also put in place a number of changes under the new tax regime which applies to all pension scheme from 6 April 2006. Principal among these are:

- Facility to count more than 40 years membership of the scheme;
- Facility to increase the amount of tax free lump sum by means of commuting part of pension;
- Removal of previous limits on contributions;
- Removal of the earnings cap, with steps taken to avoid windfall gains for some higher paid members; and
- Introduction of preliminary but significant steps towards the concept of flexible retirement, which will smooth scheme members' transition from employment to retirement.

7.5 The regulations follow a statutory consultation exercise on draft amendments which ran from 5 December 2005 until 28 February 2006. Some 600 responses were received alongside additional campaign correspondence from individuals totalling approximately 1% of the scheme's current membership. Subject to some technical and administrative concerns, the proposals associated with the new tax regime were largely supported by those who commented. However, the majority of individuals responding were against the removal of the 85 year rule, despite its being age-discriminatory, and were in favour of lifetime protections for existing scheme members, without providing any means of objectively justifying such an approach.

7.6 Before proceeding in regulation, Ministers gave full consideration to the views expressed in response to the consultation and to the discussions held between LGPS interests, including the trades unions and the local government employers, since May 2005. Indeed, consideration has been given to these issues, in the context of the long-term aim of developing a new-look scheme, since July 2003.

7.7 These regulations seek to stabilise the costs facing the Scheme in the light of increasing longevity. They set the basis for ongoing discussions concerning the development of a new-look Scheme to meet the needs of a workforce which is markedly different in terms of demographics and working patterns since 1974, when the benefit structure of the Scheme was last subject to major reform.

8. Impact

8.1 A Regulatory Impact Assessment is attached to this Memorandum.

9. Contact

9.1 Brian Town at the Office of the Deputy Prime Minister (Tel: 020 7944 6015 or e-mail: brian.town@odpm.gsi.gov.uk) can answer any queries regarding the instrument.

FINAL REGULATORY IMPACT ASSESSMENT

LOCAL GOVERNMENT PENSION SCHEME (AMENDMENT) REGULATIONS 2006

Local Government and Firefighters' Pensions Schemes Division
ODPM
28 March 2006

LOCAL GOVERNMENT PENSION SCHEME (AMENDMENT) REGULATIONS 2006

FINAL REGULATORY IMPACT ASSESSMENT

Contents

FINAL REGULATORY IMPACT ASSESSMENT

Title of Proposal

1. Local Government Pension Scheme (Amendment) Regulations 2006.

Purpose and Intended Effect of Measure

Objective

2. To introduce measures to ensure the ongoing cost stability of the Local Government Pension Scheme following the revocation of the Local Government Pension Scheme (Amendment) (No.2) Regulations 2004 and the resulting reinstatement of the 85 year rule in the LGPS; and

3. To ensure compliance with EU and UK age discrimination[1].

The relevant amending regulations

Local Government Pension Scheme (Amendment) (No.2) Regulations 2004
("the No.2 Regulations")

- removed the 85 year rule from 1 April 2005, subject to transitional protections for those who would satisfy the 85 year rule and would be at least 60 by 2013; and
- increased the minimum pension age (other than on grounds of ill-health) from 50 to 55.

The Local Government Pension Scheme (Amendment) Regulations 2005
(the "Amendment Regulations 2005")

- revoked the Local Government Pension Scheme (Amendment) (No.2) Regulations 2004.

The Local Government Pension Scheme (Amendment) Regulations 2006
(the "2006 Regulations")

- implement the recommendation outlined in this RIA; and
- introduce amendments necessary to bring the scheme in line with the new tax regime.

Background

4. The Secretary of State is responsible for the policy development and overall regulatory stewardship of the Local Government Pension Scheme (LGPS) in England and Wales and, using the powers under the Superannuation Act 1972, sets the statutory framework within secondary legislation for the management, investment and administration of the Scheme.

5. Following the revocation of the No.2 Regulations the Deputy Prime Minister invited representatives of the local government employers and trades unions, in July 2005, to develop realistic and costed measures by the autumn, to fully meet the identified costs arising from the decision to revoke the No.2 Regulations. Further background information is at Annex A.

6. The Government is committed to providing stable and attractive benefits to current and future Scheme members. It is imperative, therefore, for the Scheme's affordability and sustainability that the effects of revocation are managed prudently, and so help to ensure its ongoing solvency.

[1]Council Directive 2000/78/EC, which establishes a general framework for equal treatment in employment and occupation, and the Department of Trade and Industry's Employment Equality (Age) Regulations 2006.

7. This Regulatory Impact Assessment (RIA) accompanies the Local Government Pension Scheme (Amendment) 2006 Regulations, which also contain amendments associated with the new tax regime brought about by the Finance Act 2004, which were originally consulted on from 15 July to 16 September 2005. These changes are not included in the scope of this RIA, since they were addressed in the assessment carried out for the Finance Act 2004.

8. A statutory consultation was conducted on the proposals in draft form from 5 December 2005 to 28 February 2006. The RIA was compiled, having considered the responses to the consultation, to assess the costs and benefits of the options available to meet the cost of revocation, and the options for removing the 85 year rule and transitional protections.

Rationale for government intervention

9. The 85 year rule has to be removed from the LGPS by no later than 1 October 2006 in order to comply with domestic age discrimination legislation which implements the Framework Directive (Council Directive 2000/78/EC). An explanation of how the 85 year rule provision operates, how it discriminates on grounds of age and why it must be removed from the Scheme is outlined in Annex B.

10. However, the No.2 Regulations removed the rule from 1 April 2005. The Government's stated policy on the LGPS since July 2003 has been that one of the reasons for removing the 85 year rule in advance of the deadline of 1 October 2006 was to assist in reducing employers' cost pressures and to mitigate the anticipated rate of employers' contribution increases following the 2004 valuations of the LGPS.

11. At that time, the "savings" were estimated to be 2 – 2.5% of pensionable payroll, although these savings would not be fully realised initially because some of them were recycled into transitional protections for existing scheme members until 2013.

12. Revoking the No.2 Regulations in June 2005 meant that the reduction in cost pressures that the changes were intended to achieve would not be delivered. This therefore increased the cost of the Scheme relative to that calculated at the 2004 valuations. The longer the 85 year rule remained restored in the scheme, the greater these new cost pressures would become.

13. Following an updated assessment of the LGPS 2004 valuation reports, the Government Actuary's Department (GAD) concluded that the cost of revocation, in excess of the cost of the transitional protections until 2013, was close to £400 million in 2005/06 across all LGPS employers. This estimate was confirmed by the 2005 mini fund valuations which calculated the cost to be some £435 million in 2005/06 across all LGPS employers.

14. To ensure no additional costs from the revocation fell on government, local authorities or taxpayers, the government was committed to introducing further regulations dealing with these cost pressures to ensure the ongoing solvency of the Scheme and to provide certainty for local authorities' finances generally, as their budgets had factored in their pension costs based on the recommendations of the 2004 valuations.

Consultation

The Tripartite Committee and working groups

15. A Tripartite Committee was established by the Deputy Prime Minister, and with the agreement of the trades unions and local government employers, in March 2005 when the Government indicated it was minded to revoke the No.2 Regulations. A number of working groups were also established subsequently under this framework.

16. The purpose of the Tripartite Committee was to ensure effective and co-ordinated progress on the development of the Scheme in general and to progress the development of costed proposals to meet the liabilities arising from revocation, as invited by the Deputy Prime Minister.

17. The Tripartite Committee has met 7 times, and an additional 30 (approx.) working level meetings have taken place since May 2005 with the following organisations represented:

Trades unions:	TUC, UNISON, GMB, Amicus, UCATT, TGWU, CYWU, Aspect, AEP
Local authority employers: LGA, EO	
Other LGPS employers:	EA, UCEA, AoC and other employers, via administering authorities
Actuarial interests:	GAD, ACA, UPS, AON, Hymans Robertson
Other professional bodies:	CIPFA, SOCPO, ALACE, SOLACE and various Treasurers' Societies

Statutory consultation

18. Following the 21 November meeting of the Tripartite Committee, a 12 week statutory consultation on the draft Local Government Pension Scheme (Amendment) Regulations 2006 (the "draft Regulations"), under the working title of the Local Government Pension Scheme (Amendment) (No.3) Regulations 2005, took place from 5 December 2005 to 28 February 2006.

19. The consultation documents relating to the draft Regulations were made available on the ODPM website on 5 December 2005. They were also specifically addressed to the organizations listed at Annex D. A summary of the responses received to the consultation is at Annex E.

Progress of the Tripartite Committee, leading up to the consultation on the draft Regulations

20. By the end of November, while all parties were agreed that there was a cost to be met, there remained some disagreement as to the size of that cost. The development of actuarial costings is explained in Annex G.

21. The Tri-partite Committee agreed that this cost (whatever the precise figure turned out to be) could be met by using the saving generated by allowing members the flexibility to take an increased tax-free lump sum on retirement by "commuting" some of their pension. An explanation of what this flexibility is and how this would generate a saving is at Annex C. This proposal was widely consulted on in the draft Regulations.

Progress of the Tripartite Committee, leading up to the making and laying of the 2006 Regulations

22. The covering letter to the statutory consultation on the draft Regulations had made clear that, as long as any alternative proposals for transitional protections for existing scheme members from the removal of the 85 year rule were affordable and could be legally provided, consideration would be given to them as part of the consultation process. The members of the Tri-partite Committee were specifically invited to come forward with such alternative proposals.

23. During and immediately following the twelve-week statutory consultation period, there was much discussion amongst the Tripartite Committee members with regards the scope for using the savings resulting from commutation to provide extended transitional protection arrangements for existing scheme members as well as to pay for the cost of revocation. Some 15 (approx.) working level meetings took place to enable LGPS interests to discuss these issues.

24. The Tripartite Committee remained in agreement that the costs of revocation could be met through commutation, but there was disagreement as to the additional scope for savings. Annex G provides more detail about the actuarial costings discussed and developed.

25. It had been suggested by the trades unions and their actuarial advisors that if savings from commutation associated with existing and new members' accrued and future service were included, these could potentially pay for lifetime protections for existing scheme members over a long period of time, if these could be legally provided. However, neither GAD nor the actuaries advising the local government employers recommended taking this approach.

26. The following reasons were identified:

- Using savings resulting from new scheme members to fund protections for a sub-set of existing scheme members raised questions of equity.

- Costings were based on assumptions, and there was a risk that these would not be realised, especially when these were based on scheme member choice.

- Even if savings were forthcoming, this would most likely lead to a short term increase in employer contribution rates at the 2007 valuation of 1-2%, because the 2004 valuation had assumed protections only until 2013.

- Any spreading period of greater than 20 years could be subject to challenge.

- Lifetime protections for existing scheme members (from the removal of the 85 year rule) could not be legally objectively justified.

27. However, as the commutation savings relating to <u>existing scheme members' accrued service</u> [GAD had costed this as being some £1¼ billion] were estimated to be greater than the cost of revocation [GAD had costed this as being some £520 - 590 million], any excess could be used to pay for further protections at this time.

28. Alternatively it could be considered in the context of the new-look Scheme alongside any commutation saving relating to future accrual of new and existing scheme members. The Government's commitment to recycling up to 50% of the savings associated with the removal of the 85 year rule in the context of an affordable and legal new-look Scheme from 2008 was also re-stated.

<u>Consultation within government</u>

29. Proposals were also developed through discussion and consultation with the following government departments:

HM Treasury, Department for Trade and Industry, Government Actuary's Department,
Scottish Public Pensions Agency, DoE (NI)

Options

30. This RIA considers options for measures for ensuring the ongoing cost stability of the Scheme following the revocation of the Amendment No.2 Regulations 2004, the extent of the continuation of the 85 year rule and transitional protections. A number of options have been identified, which could be implemented in combination or singly:

Ensuring ongoing solvency of the Scheme following the revocation of the Amendment No.2 Regulations 2004

1) Do nothing
2) Increase tax-free lump sum
3) Increase employee contributions

The extent of the continuation of the 85 year rule

4) Do nothing
5) Remove the 85 year rule from 1 October 2006 for all scheme members

Transitional protections for existing scheme members

6) Do nothing
7) Protect those who would otherwise have satisfied the 85 year rule and reach age 60 by 31 March 2013
8) Protect all existing scheme members until 31 March 2008[2]
9) Protect those who would otherwise have satisfied the 85 year rule and reach age 60 by 31 March 2018
10) Allow facility to buy-back any actuarial reduction resulting from the removal of the 85 year rule for those choosing to take early retirement
11) Allow members to select, in advance, an early retirement date and pay relevant extra contributions

31. These Options were considered in the context of the following issues:

- The No.2 Regulations removed the 85 year rule, except for transitional protections for those who would otherwise have satisfied the 85 year from and would be 60 by 2013. The 2004 actuarial valuations assumed the resulting savings would be forthcoming.

- It was made clear, as part of the consultation material on regulations to revoke the No.2 Regulations 2004, that any savings foregone through revocation would need to be found by other means.

- These means would have to be both identifiable and prudent

- The longer the 85 year rule remained in the Scheme, the greater the costs that would have to be faced.

- The 85 year rule would also have to be removed by 1 October 2006 in any case in order to comply with domestic age discrimination legislation to implement the Framework Directive for equal treatment in employment and occupation.

- Any retention of the provision beyond 1 October (including any transitional protections) would need to be objectively justified.

[2] This would effectively provide existing scheme members (i.e. all scheme members in active service immediately prior to the date at which the 85 year rule is removed) with another 18 months of service accrual under the 85 year rule. Any actuarial reduction would therefore be in relation to future service accrued after April 2008 since this effectively becomes the date when the 85 year rule is removed for existing scheme members.

- Any additional protections above those introduced by the No.2 Regulations would need to be paid for from additional funds, identifiable at the current time.

Costs and benefits

Information-gathering programmes to assist in the development of fully costed proposals

32. It was imperative for all stakeholders that there was an evidential base for the costs and benefits of the proposals. Various initiatives to determine the evidential base were undertaken, including most importantly the actuarial costings of the cost pressures to be met and the available scope for savings. The initiatives taken forward are listed below but are explained in detail in Annex F (items a and b) and Annex G (items c, d, e and f):

    a) data gathering exercise organised by the Employers' Organisation (EO) to consider the relationship between the retirement age of members in the Scheme and satisfying the rule of 85;

    b) commissioning by ODPM of a demographic study of the LGPS in England and Wales, the terms of reference having been agreed by the trades unions and the local government empoyers;

    c) administering authorities agreeing to provide copies of the 2004 valuation reports to trades unions and their actuarial advisor;

    d) LGPS funds to provide funding updates as at 31 March 2005, including on the cost pressures resulting from the revocation, by 30 September 2005;

    e) commissioning by ODPM of actuarial costings of the scope for saving associated with allowing increased commutation as under the Finance Act 2004 for subsequent analysis by and discussion with other parties; and

    f) commissioning by ODPM of actuarial costings from GAD on the cost of various options for extending protection for subsequent analysis by and discussion with other parties.

Breakdown of costs and benefits

33. Full analysis of the costs and benefits of each of the Options is at Annex H and a summary table follows on pages 12-13.

Sectors and groups affected

34. Any amendments to the LGPS benefit structure could impact on the 1.6 million people who are currently active LGPS members. Additionally, the 0.7 million former employees entitled to deferred benefits would also be able to take advantage of the increased lump sum by commuting some of their pension when they take their pension benefits.

35. These proposals introduce measures to meet the cost of revocation, and so return the funding position to that assumed at the 2004 valuation. Therefore there should be no effect on the costs faced by LGPS employers as a result of these changes.

36. It is too early to be precise at this stage about what impact the wider changes which bring the Scheme in line with the new tax regime from 6 April 2006 will have on employers' costs in the long term. Development of proposals for a new-look scheme is underway and the next fund valuation takes place in 2007. In the context of these reviews, it would be reasonable to reconsider the effect of such adjustments to the scheme cost once there is some evidential experience available. This matter is, however, outside the scope of this RIA.

Race equality assessment

37. There are no race equality issues concerning these proposals.

Health impact assessment

38. The Normal Retirement Age for the LGPS is 65. However, the 85 year rule allows Scheme members who choose to retire from age 60, or from age 50 with employer's consent to take an unreduced pension if their age plus service equals 85 years. The trades unions and some actuaries have expressed concern that there may be more instances of ill-health retirement if the 85 year rule is removed from the Scheme and LGPS employees have to work longer. No evidence has been supplied, at this stage, to support this assertion. If the 85 year rule is removed from the Scheme any increase in ill-health retirements will become apparent at the tri-ennial actuarial valuations of the funds.

39. It is intended that flexible retirement provisions would help to mitigate this risk. Flexible retirement will allow Scheme members to continue working at reduced hours/grade, and accruing pension benefit whilst starting to draw their pension. This would remove the current cliff edge where a Scheme member moves from full time work to retirement.

Rural considerations

40. In their report, *Review of Demographic Patterns* (as detailed in Annex F), Hymans Robertson looked at longevity figures in the LGPS and analysed the mortality experience for their England and Wales LGPS client funds over the three years from 2001-2004. A subset of the pensioner data they considered, for officers retiring other than through ill-health, related to regional variation.

41. The results of this analysis showed that the geographic (North-South)[3] gap in mortality figures was slightly less pronounced than Urban-Rural[4] differences. The gap between London and the rest of the South was the most significant. Overall these figures showed that those in Rural areas were living, on average, 1.5 years longer than those in Urban areas. This means that increasing longevity will have a greater impact on cost pressures facing the LGPS Rural funds than it will for Urban funds.

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[3] Broadly speaking anything south of the M4 was considered south, with anything above being considered north. South excluded London, which was considered separately.

[4] County Councils were labelled "rural" and Metropolitan Funds were labelled "Urban"

Small Firms' Impact Test (SFIT)

42. The proposals relate in the main to the public sector. However, the consultation on the draft proposals also involved the BSA, CBI and administering authorities were asked to bring the proposals to the attention of contractors, who may have been admitted to the Scheme under the provision in the regulations which allows this.

Competition Assessment

43. This is not required for these proposals.

Enforcement, Sanctions and Monitoring

Enforcement

44. This is not required for these proposals.

Sanctions

45. This is not required for these proposals.

Monitoring and review

46. All LGPS funds undergo an actuarial valuation every three years. The last valuation took place at March 2004 and the next will take place at March 2007. LGPS administering authorities' pension funds and their actuarial context are both separately monitored regularly by investment consultants and actuaries. In addition, Funding Strategy Statements must be regularly reviewed and provide a statutory framework for the relevant actuarial valuation exercise and any informal, interim reviews.

Summary of costs and benefits

Ensuring ongoing solvency of the Scheme following the revocation of the Amendment No.2 Regulations 2004

Option	Total cost per annum Economic, environmental, social	Total benefit per annum Economic, environmental, social
1 – Do nothing	**Economic –** Some £340-390 million in 2005/06. A cost of 2-2.5% of pensionable payroll p.a. for funds in England and Wales until 85 year rule is removed. (The 2004 valuations assumed the rule's removal from 1 April 2005.) **Environmental –** None. **Social –** Would jeopardise the long term future of scheme	**Economic –** None. **Environmental –** None. **Social –** Would maintain the status quo for existing scheme members.
2 - Increase tax-free lump sum	**Economic –** Potential loss of revenue for exchequer, potential increase draw on benefits. **Environmental –** None. **Social –** Personal circumstances might mean this would not be a financially sound decision for some scheme members; might need to seek financial advice.	**Economic –** £1 1/4 billion in relation to accrued service of existing scheme members; ½ % of pensionable payroll p.a. for future service of existing scheme members; 1/3 % of pensionable payroll p.a. for new members **Environmental –** None. **Social –** More flexibility and choice to take more tax-free cash on retirement
3 – Increase employee contributions	**Economic –** Could result in call for increased pay deals, potential reduction in total scheme membership. **Environmental –** None. **Social –** Poorly targeted – would affect all scheme members. Might lead to higher incidence of opting-out, which could lead to increased poverty in retirement amongst the lower paid.	**Economic –** 1% increase in employee contributions for 2006/07 and 2007/08 might generate an extra £500 million. **Environmental –** None. **Social –** None.

The extent of the continuation of the 85 year rule

Option	Total cost per annum Economic, environmental, social	Total benefit per annum Economic, environmental, social
4 – Do nothing	**Economic –** a cost of 2 – 2.5% payroll p.a. long-term until 85 year rule is removed. (The 2004 valuations assumed the rule's removal from 1 April 2005.) **Environmental –** None. **Social -** Continuation of a discriminatory provision, risk of challenge.	**Economic –** None. **Environmental –** None. **Social –** No change to benefit provision - this would be overwhelmingly supported by existing scheme members.
5 – Remove the 85 year rule from 1 October 2006 for all scheme members	**Economic –** £520 – 590 million for funds in England and Wales (for the 18 months from 1 April 2005 to 1 October 2006). **Environmental –** None. **Social –** If they still wished to retire early, some scheme members would retire on a reduced pension where under the 85 year rule they would have been able to retire early unreduced.	**Economic –** Would save 2 – 2.5% of payroll p.a. long-term, fulfilling the fund actuaries' assumptions at the 2004 valuations. Could potentially increase the proportion of LGPS members age 50 plus who are economically-active. **Environmental –** None. **Social –** Step towards equality proofing the scheme.

Transitional protections for existing scheme members

Option	Total cost per annum	Total benefit per annum

	Economic, environmental, social	Economic, environmental, social
6 – Do nothing	**Economic –** None. **Environmental –** None. **Social –** Existing scheme members might have a legitimate expectation that the 2013 protections in the Amendment No.2 Regulations 2004 would be forthcoming. Majority of individuals responding to the consultation were against changes for existing scheme members.	**Economic –** Close to £1 billion (this being the cost of the 2013 protections from 1 April 2005 assumed at the 2004 valuation) would be available for recycling elsewhere in the scheme. **Environmental –** None. **Social –** Providing no protections could be the most equitable way forward as it would not involve the continuation of a discriminatory measure.
7 – Protect those who would otherwise have satisfied the 85 year rule and reach age 60 by 31 March 2013	**Economic –** None – assumed at 2004 valuations. **Environmental –** None. **Social –** Continuation of a discriminatory provision until 2013 for those who will benefit from it.	**Economic –** None – assumed at 2004 valuations. **Environmental –** None. **Social –** Would protect scheme members within seven years of retirement who have no time to make alternative arrangements, fulfilling the arguably legitimate expectation of existing scheme members that the 2013 protections in the Amendment No.2 Regulations 2004 would be forthcoming
8 – Protect all existing scheme members until 31 March 2008	**Economic –** Just over an additional £1/2 billion in addition to the 2013 protections. Less money available in the new-look scheme for benefit improvements. **Environmental –** None. **Social –** Continuation of a discriminatory provision until 2008 for all existing scheme members.	**Economic –** None. **Environmental –** None. **Social –** Would provide an additional 18 months service under the 85 year rule for <u>all</u> existing scheme members to allow a smooth transition to a new-look scheme in April 2008 (more equitable).
9. Protect those who would otherwise have satisfied the 85 year rule and reach age 60 by 31 March 2018	**Economic –** Around £1 billion in addition to the 2013 protections. Less money available in the new-look scheme for benefit improvements. **Environmental –** None. **Social –** Continuation of a discriminatory provision until 2018 for those who will benefit from it.	**Economic –** None. **Environmental –** None. **Social –** Would protect scheme members within 12 years of retirement who have no time to make alternative arrangements – a larger group than would be protected under Option 7.
10 – Allow buy-back of any actuarial reduction resulting from the removal of the 85 year rule	**Economic –** None - cost neutral factors. **Environmental –** None. **Social –** Factors may seem unattractive, especially to those with little disposable income.	**Economic –** None - cost neutral factors. **Environmental –** None. **Social –** Scheme members would be able to make extra contributions to retire as they had planned regardless of the removal of the 85 year rule. Supported by respondees to consultation.
11 – Flexible retirement	**Economic –** Difficult to predict – to review in 2007 and in the context of a new-look scheme for 2008. **Environmental –** None. **Social –** None.	**Economic –** Difficult to predict – to review in 2007 and in the context of a new-look scheme for 2008. Could potentially increase the proportion of LGPS members age 50 plus who are economically-active. Employers could better retain and manage workforce. **Environmental –** None. **Social –** More attractive for scheme members to remain in employment longer and therefore less likely to retire in poverty.

Recommendation

47. The recommendation is to adopt the following Options:

Ensuring ongoing solvency of the Scheme following the revocation of the Amendment No.2 Regulations 2004
Option 2: *Increase tax-free lump sum*

The extent of the continuation of the 85 year rule
Option 6: *Remove the 85 year rule from 1 October 2006 for all scheme members*

Transitional protections for existing scheme members
Option 7: *Protect those who would otherwise have satisfied the 85 year rule and reach age 60 by 31 March 2013*
Option 10: *Allow buy-back of any actuarial reduction resulting from the removal of the 85 year rule*
Option 11: *Flexible retirement*

48. Introducing a facility to take more tax free lump sum from April 2006 (Option 2), as explained in Annex C, will reduce the liabilities on the Scheme. Based on various assumptions, most importantly that there is a 50% take-up and a commutation rate of 12:1, costs may be reduced by a capital value of £1 1/4 billion in relation to accrued service of existing scheme members, as detailed in Annex G.

49. Removing the 85 year rule from the Scheme from 1 October 2006 (Option 6) leaves a cost of some £520-590 million to be met.

50. The cost of protecting those existing scheme members who would otherwise have satisfied the 85 year rule and reach age 60 by 31 March 2013 (Option 7) was already accounted for at the 2004 valuations

51. Option 10 is cost-neutral and, while the cost of Option 11 is currently somewhat difficult to predict, this will be reviewed and considered in the context of the new-look scheme.

52. The recommendation set out above could therefore generate a net saving to the Scheme of an estimated £660–730 million. This can be considered in the context of the new-look Scheme alongside any commutation saving relating to future accrual of new and existing scheme members.

53. In accordance with this recommendation, local authorities would be required to spread costs in line with the fund's Funding Strategy Statement, which would have been produced in connection with the 2004 actuarial valuation.

Implementation and Delivery Plan

54. The statutory consultation on draft amending regulations took place between 5 December 2006 and 28 February 2006. Having considered the responses received, and the outcome of the discussions with LGPS interests, final amending regulations (the Local Government Pension Scheme (Amendment) Regulations 2006) are being laid in Parliament on 29 March 2006.

Post-Implementation Review

55. Actuarial valuations of LGPS funds take place every three years. 31 March 2007 is the date of the next actuarial valuation of the individual pension funds as set out in the Local Government Pension Scheme Regulations 1997.

56. If experience at the next valuation in 2007 indicated that the assumed reduction in liabilities was not occurring as required to meet the cost of revocation and the additional protections until 2008, two options would apply:

   a. if the reduction in liabilities was greater than expected then any extra saving could be taken into account to meet costs in the new-look Scheme from 2008;

   b. if the reduction in liabilities was less than expected then there would be less money available for improvements in the new-look Scheme.

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Declaration and Publication

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs

Signed ……Phil Woolas……………………………………

***Date* ………29th March 2006…………………………………….**

Phil Woolas MP
Minister for Local Government
Office of the Deputy Prime Minister

ANNEX A

Background

Local Government Pension Scheme (Amendment) (No.2) Regulations 2004 (the "No 2 Regulations")

1. The No. 2 Regulations were introduced in December 2004 and came into effect on 1 April 2005. They made two changes to the Scheme. The first ensured that the earliest age at which a pension could be paid, other than on grounds of ill-health, was increased from 50 to 55. The second phased out the so-called 85 year rule (explained in Annex B) from the Scheme.

2. Transitional protection applied to Scheme members who were already 50 by 31 March 2005, and also to those who would otherwise have satisfied the 85 year rule and reached age 60 by 31 March 2013.. Had the latter protection not been provided then there would have been an additional average saving of close to £1bn over the 8 years from 2005 to 2013

3. The No.2 Regulations were introduced for a number of purposes. Firstly they were in line with wider Government policy which proposed a move to a retirement age of 65 for all public sector workers by 2006, linked to age discrimination legislation. The LGPS, unlike other public service schemes, has had a normal retirement age of 65 ever since it was established on a national basis in the 1920s, but it has an early-retirement provision known as the 85 year rule, which allows Scheme members to retire before 65 on an unreduced pension if their age plus service equals 85 (Annex B).

4. Secondly, it was considered that the 85 year rule was age-discriminatory and would therefore need to be removed by no later than October 2006 to comply with age-discrimination legislation and to deliver an equality-proofed new-look Scheme. Thirdly, its removal would positively influence the outcomes for employers of the expected increases in their contributions arising from the 2004 valuation

5. The Local Government Pension Scheme Regulations 1997 require local authority pension funds to carry out actuarial valuations every three years. The LGPS fund actuaries acted on the regulations once they came into force. It was subsequently estimated, as part of the 2004 actuarial valuation exercise, that the removal of the 85 year rule represented a saving to the funds of 2-2.5% of pensionable payroll per annum. However, this level of saving would not be realised in full until 2013/14, when the transitional protections would come to an end. These transitional protections would cost close to £1bn over the 8 years - 2005 to 2013

The Local Government Pension Scheme (Amendment) Regulations 2005

6. However, following the laying of the No.2 Regulations in December 2004, significant concerns were expressed by Members of Parliament, trades unions and scheme members. The DPM issued a statement on 18 March 2005 that he was minded to revoke the No.2 Regulations, subject to statutory consultation, and with retrospective effect to 1 April 2005. The statement also announced that the DPM was establishing a Tripartite Committee, with key stakeholders, to consider what measures should be put in place to ensure the Scheme's affordability and sustainability for the longer term

7. Statutory consultation began on 1 April on draft proposed amending regulations which would have the effect of revoking the No.2 Regulations, which had come into force that day. It was made clear, as part of the consultation material, that no new money from government or local authorities would be made available and that any savings foregone if revocation occurred would need to be found from elsewhere.

8. The consultation closed on 31 May and the responses received were then considered. On 13 July a statement was made to the Houses of Parliament that the No.2 Regulations were to be revoked with retrospective effect to 1 April, and further necessary regulations would be introduced to take effect from 1 April 2006 to deal with any cost implications, which should not fall to central or local government. The Local Government Pension Scheme (Amendment)

Regulations 2005 (the "Amendment Regulations 2005"), achieving revocation, were laid the same day and came into effect on 3 August 2005.

<u>The consequences of revocation</u>

9. To fulfil this commitment that the costs of revocation would not fall to the local or national taxpayer, representatives of the local government employers and trades unions were invited to develop realistic and costed measures by the autumn, to fully meet the identified costs arising from the decision to revoke. The framework provided by the Tripartite Committee would ensure effective and co-ordinated progress of the development of the LGPS.

10. To assist in that process and as a measure to ensure the continued stability of the Scheme, an amendment was also made by the Amendment Regulations 2005 to provide each LGPS administering authority with the vires to request an mini valuation of their pension fund, as at 31 March 2005, so as to properly identify cost pressures resulting from the revocation.

ANNEX B

The 85 year rule

1. The LGPS has a normal retirement age of 65. However, the 85 year rule allows Scheme members who choose to retire early from 60 to take an unreduced full pension where their age plus years of service equals 85 years. Scheme members aged 50 to 60 can retire with their employers' consent, and if the rule is satisfied no actuarial reduction will be applied to the pension released early.

Equality-proofing the LGPS

2. The Council Directive 2000/78/EC establishes a general framework for equal treatment in employment and occupation. To comply with the Directive, the Department of Trade and Industry consulted on draft Employment Equality (Age) Regulations 2006. The regulations will come into force from 1 October 2006.

3. The Government's view is that the 85 year rule is age discriminatory and therefore must be removed from the Scheme in order to comply with the Directive. This is because the 85 year rule is a condition which takes the sum of the member's age and pensionable service to determine eligibility to unreduced payment of pension benefits before the scheme's normal retirement age of 65. If a member does not have sufficient age and pensionable service, they are not able to take unreduced benefit.

4. The following example may help to illustrate the age-discriminatory aspects of the 85 year rule:

   Take two members X and Y - both join at the same time and serve for 5 years.

   X joins at 30 and leaves at 35. She receives a preserved pension payable from age 60, because she satisfies the 85 year rule.

   Y joins at 50 and leaves at 55. She receives a preserved pension payable from age 65, or an actuarially reduced pension at age 60, because she does not satisfy the 85 rule.

   Y loses out because she was older when she joined, and this is age discriminatory.

5. It is permissible to seek to objectively justify the retention of a discriminatory measure such as the 85 year rule. The Government believes that some degree of protections can be objectively justified for those Scheme members close to retirement, as it would not be easily possible for them to make alternative arrangements nor reasonable to require them to attempt to do so. The range of protections considered follows in Annex H.

ANNEX C

Flexibility to take an increased tax-free lump sum

1. The LGPS is a defined-benefit, final salary pension scheme, with an annual accrual rate of $1/80^{th}$ of final salary and a normal retirement age of 65. This means that on retirement at age 65, scheme members receive a pension payable per annum calculated as follows:

   (final (pensionable) pay) x (number of years scheme membership) x 1/80

2. Additionally, Scheme members receive a tax-free lump sum on retirement of three times the amount of this value. This arrangement is known as a $1/80^{th}$: $3/80^{th}$ scheme.

3. From 6 April 2006, the new simplified HM Revenue and Customs (HMRC) tax regime will permit Scheme members to take larger lump sums of up to 25% of the capital value of the pension as a tax-free lump sum, when they retire.

4. HMRC use a stipulated conversion formula of (20 times annual pension plus tax-free lump sum on retirement) in order to calculate the capital value of a member's pension. The current 3 times final pension permitted in the LGPS equates to close to 15% of the capital value. The new HMRC regime therefore allows scheme members flexibility to take more tax-free lump sum on retirement.

5. Where Scheme members chose to increase their tax-free lump sum above the current $3/80^{th}$ provision, this increase would be paid for by the Scheme member swapping pension for tax-free cash at a certain commutation factor. The proposed commutation factor is 12:1. This means for every £1 of pension foregone, the Scheme member would receive an additional £12 tax-free as a lump sum payment on retirement.

How would this flexibility result in a saving to the Scheme?

6. The Government Actuary's Department (GAD) have calculated that this provision could result in an overall saving to the LGPS. The saving would occur when a scheme member, who has commuted some of their pension to lump sum on retirement, receives their pension in payment for greater than 12 years. This means that the Scheme would have effectively made a saving compared to the costs that could have been payable, had the Scheme member not chosen to commute additional pension to lump sum.

7. The calculation is necessarily based on a number of assumptions, most importantly that 50% of Scheme members would continue to only take the $3/80^{th}$ lump sum and that 50% would take the new maximum permissible under the new tax regime. These assumptions have been discussed and refined where necessary in discussion with the actuaries advising trades unions and local government employers, as outlined in Annex G.

ANNEX D

The consultation documents accompanying the draft Local Government Pension Scheme (Amendment) (No.3) Regulations were addressed to the following organizations:

Public (including statutory) consultation was conducted with:

Trades Union Congress
UNISON
GMB
Transport and General Workers Union (TGWU)
Union of Construction, Allied Trades and Technicians (UCATT)
National Association of Probation Officers (NAPO)
AMICUS
Community and Youth Workers Union (CYWU)
Aspect
Association of Educational Psychologists (AEP)

Employers and Administering Authorities
Local Government Association (LGA)
Employers' Organisation (EO)
County Councils (England)
District Councils (England)
Metropolitan Borough Councils (England)
Unitary Councils (England)
County and County Borough Councils in Wales
London Borough Councils
South Yorkshire Pensions Authority
London Pension Fund Authority
New Towns Pension Fund
Fire and Rescue Authorities in England and Wales
Police Authorities in England and Wales

UCEA
Environment Agency.
City of London Corporation
South Yorkshire PTA
West Midlands PTA
National Probation Service for England and Wales
Other Scheme employers (through the EO and fund administering authorities)

Other representative bodies
Association of Consulting Actuaries (ACA)
CIPFA
Audit Commission
Society of County Treasurers
Society of District Council Treasurers
Welsh Treasurers
Society of Metropolitan Treasurers
Society of London Treasurers
LGPC
SOLACE
ALACE
SLCC
Society of Chief Personnel Officers (SOCPO)
ALAMA
Confederation of British Industry (CBI)
Building Societies Association (BSA)

ANNEX E

Summary of responses to the statutory consultation on the draft Regulations

A 12 week statutory consultation on the draft Local Government Pension Scheme (Amendment) Regulations 2006, under the working title of the Local Government Pension Scheme (Amendment) (No.3) Regulations 2005, took place from 5 December 2005 to 28 February 2006. The following concerns a headline summary of responses received to this consultation.

Number and breakdown of responses received

- 174 employers/administering authorities responded, including the LGA

- 144 responses from trades unions, of which 10 national responses

- 358 individuals responded

Some 16,000 campaign postcards and some 600 additional letters were received. The sum total of this individual correspondence corresponds to 1% (approx.) of the total active Scheme membership.

Response to the proposal to allow members to take an increased lump sum on retirement, which will also pay for the cost of revocation

- significant support across all groups of respondees

- some concern that the commutation rate on offer was too unfavourable

- some concern that assumed savings would not be forthcoming

Response to the proposals associated with the new tax regime

- low response on these aspects

- those who commented were overwhelmingly in favour, subject to a number of technical and administrative points

- much support for extending the flexible retirement provisions – proposed developing this further in the new-look scheme

- some limited concern that high-earners would not be able to benefit as much as they would like from the new taxation regime

- some respondees recognised that the LGPS regulations should not simply replicate HMCR provisions and accepted the need for enabling powers

- the need to liaise with GAD and the EO to ensure pension managers had access to the relevant guidance was also recognised

Response to the proposal to remove the 85 year rule from 1 October 2006 for all scheme members

- almost all respondees commented on this aspect

- largely supported by local authority employers and administering authorities

- trades unions, individuals, a number of police and fire authorities and some other LGPS employers totally against this proposal

- overwhelming support amongst those who commented for the proposal to allow members to make extra contributions to offset any reduction

- much support for extending this provision to the full scheme membership, rather than just those existing scheme members not protected under the transitional arrangements

Response to the proposal to repeat transitional protection arrangements until 31 March 2013

- significant support from local authority employers and administering authorities

- trades unions, a number of police and fire authorities, and some other LGPS employers against the proposal

- a common concern was the cliff-edge that the proposed protections produced which was not considered to be fair

- over half of respondees commented about lifetime protections, even though this was not contained in the consultation paper.

- almost all who commented were in favour of this, with the exception of some local authority employers and administering authorities, but did not explain how lifetime protection could be legally objectively justified.

<u>Results of the information-gathering programmes: Part 1: Retirement patterns and demographic studies</u>

Data gathering exercise organised by the Employers' Organisation (EO)

1. The EO gathered information from local authorities on:

    a) the average age of retirement of all LGPS pensioners broken down by employer type and gender;

    b) the average retirement age of all LGPS pensioners retiring in the year to 31st March 2005 broken down by employer type and gender;

    c) the average pension for all LGPS pensioners broken down by employer type, by gender and by type of pension; and

    d) the average pension, and the average service and average pay on which the pensions were calculated, for all pensioners retiring in the year to 31st March 2005 broken down by employer type, by gender and by type of pension.

2. Detailed scheme data was passed from the EO to the unions on 23 September 2005. An updated version was then sent on 29 September 2005

3. It was not possible for specific data to be gathered on the amount of time employees worked past their Earliest Retirement Age[5] as this date was not calculated and stored by the computer programme software used.

Commissioning of the demographic study of the LGPS in England and Wales

4. The actuarial firm Hymans Robertson LLP was commissioned to produce a demographic study of membership profiles and behaviours in the LGPS in England and Wales. Their report, *Local Government Pension Scheme in England and Wales: Review of Demographic Patterns*, September 2005, was based on terms of reference and key questions agreed between ODPM, the Employers' Organisation and the trades unions at the second Tripartite Committee on 30 June 2005.

5. The principal purpose of the report was to provide all the Tripartite Committee Stakeholders with statistical information on the demographics of the scheme membership. This covered three broad areas:

    a) the profile of employee members and pensions in payment,

    b) the retirement behaviour of employees, and

    c) the mortality experience of LGPS pensioners

[5] Earliest Retirement Age (ERA) - This is the earliest age at which an employee can retire based on their 85 year rule entitlement. For example, a Scheme member has worked in local government and contributed to the LGPS for 22 years by their 63rd birthday has an ERA of the date of their 63rd birthday, rather than the normal retirement age for the LGPS which is 65.

6. In summary the main findings of the report were as follows:

7. That the membership of the LGPS had changed significantly both since the Scheme was originally implemented in 1922, and when the existing benefit structure was introduced in the early 1970's. This had become particularly apparent since all part-timers were allowed to join in 1993.

8. 72% of the current employee membership is female, with 57% of female workers working part-time. Almost half the employee members work part-time.

9. 75% of pensions in payment are less than £5,000 a year. Women tend to be in receipt of lower pensions than men, primarily due to a combination of their shorter service and lower, part-time pay.

10. For members retiring in the LGPS between 2001 and 2004, almost 90% of the pensions of men and two-thirds of the pensions of women would have been payable without reduction at age 60, under the 85 year rule - their Earliest Retirement Age (ERA).

11. Women's ERAs are generally later than men's, due to their joining later than average.

12. Around 15% of all retirements are Scheme members who have worked past their ERA. These are known as 'late' retirements. Of these late retirements, men are more likely to continue in employment beyond their ERA than women. The average period of working late was around three years for both men and women.

13. Individuals with larger pensions tend to retire sooner than those with smaller pensions, often on redundancy grounds or in the interests of efficiency.

14. Life expectancy at birth is increasing, but is not directly relevant in the context of pension scheme funding, where the expectation of life from retirement age is most important.

15. Statistics confirmed that the UK population generally, and the LGPS population specifically, are showing reductions in mortality rates, implying material increases in the average period that pensions are in payment, compared to when the scheme rules were devised.

16. For men retiring at 65, based simply on [LGPS] population mortality, the average period that a pension is expected to be in payment has risen from 12.2 years to 16.0 years since the early 1970's, an increase of some 31%. For women, the rise is from 16.1 years to 19.0 years, a rise of some 18%.

17. Pensioners who retire from the LGPS in normal health would be expected, on average, to live around 2 to 4 years longer than pensioners in the population as a whole.

18. In conclusion Hymans Robertson surmised that the demographic evidence appeared to be a strong case for the benefit structure evolving, just as the population that it is designed to cater for is evolving. Increased longevity and a substantially increasing pensioner population (compared to working population) means retaining older workers in employment would become increasingly important.

19. The statistics revealed by the Hymans Robertson report also appear to suggest that the 85 year rule discriminates indirectly against women. This is because although they make up the majority of the workforce, on average, they have less potential service in the LGPS than men, as a result of joining the LGPS later in life, and therefore are less likely to be in a position to benefit from the rule.

Results of the information-gathering programmes: Part 2: Actuarial costings

Administering authorities provide copies of 2004 actuarial valuation reports

1. A first batch of these reports was passed to the trades unions, by the EO, on 27 July 2005. A further batch, making a complete set, was handed over by the EO in September for analysis. In addition to this the trades unions requested information direct from Local Authorities under the Freedom of Information Act 2000.

2. Drawing on the results of the 2004 fund valuations, GAD advised that actuaries had estimated the ongoing cost of the 85 year rule to be some 2-2.5% pensionable payroll p.a. long term. Based on a pensionable payroll figure of £25 billion for 2004/05, this equated to some £400 million p.a. for all 89 funds in England and Wales from 1 April 2005 to 1 April 2006 in excess of the cost of the protections for existing scheme members until 2013.

3. This cost would increase for each year or part-year that the 85 year rule remained in the scheme beyond 1 April 2006.

LGPS funds provide funding updates, including on the cost pressures resulting from the revocation

4. The mini actuarial valuation of funds in England and Wales in 2005 confirmed GAD's estimate of the one-year cost of revocation by identifying a total cost of £435 million[6] for 2005/06 in excess of the cost of the protections for existing scheme members until 2013.

5. The issues surrounding the estimates of the cost of revocation are complex and depend upon a range of demographic and financial assumptions being applied, including with regards a wide variety of individual circumstances, including retirement decisions, socio-economic factors, and health.

6. A series of actuarial meetings was therefore arranged with GAD and the actuaries advising the trades unions and the local government employers, in order to discuss these assumptions and re-consider the costings in light of any relevant evidence.

7. Following representations made by the trade union side, there was some agreement between GAD and the actuaries advising the local government employers that it could be reasonable to reduce this figure to make allowance for the effect of late retirees (those scheme members choosing to work beyond their earliest retirement age). A reasonable range for the likely total cost of revocation was then taken to be between 80-90% of the total cost falling to the funds.

8. If the figure suggested by the mini fund valuations of £435 million for 2005/06 was adjusted on this basis, this would produce a range of £340-390 million[7]. Some 80% of these costs would be estimated to relate to local authorities only. This therefore would give a range of £280 – 310 million for the cost of revocation in 2005/06 for local authorities in England and Wales.

Commissioning by ODPM of actuarial costings from GAD of the scope for saving associated with allowing increased commutation as under the Finance Act 2004 (as outlined in Annex C) for subsequent analysis by other parties

9. The issues surrounding the estimation of the saving associated with allowing increased commutation are also complex, due to the nature of the necessary assumptions about, for example, turnover, average age of retirement and member choice with regards the take-up of the maximum possible lump sum. At least five working level meetings took place with trades unions and local government employers and their actuarial advisors with regards these costings.

10. Following these meetings, GAD's revised estimates on costs were[8]:

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[6] The 18 month cost of revocation from 1 April 2005 until 1 October 2006 would be 1.5 times this figure, i.e. £650 million

[7] The 18 month cost of revocation from 1 April 2005 until 1 October 2006 would be 1.5 times this range, i.e. £520 – 590 million

[8] These figures make no allowance for wider effects, such as selection against the scheme, or wider Government effects such as residual costs by way of lost tax receipts. Amongst other assumptions,

- Scope for saving associated with accrued service for all existing scheme members at 6 April 2006 is approximately £1¼ billion

- Scope for saving associated with future service for all existing scheme members from 6 April 2006 is approximately ½% of pensionable payroll p.a.

- Scope for saving associated with new scheme members from 6 April 2006 is approximately 1/3% of pensionable payroll a year

Commissioning by ODPM of actuarial costings from GAD on the cost of various options for protection for subsequent analysis by other parties

11. The draft Regulations proposed removing the 85 year rule from the Scheme from 1 October 2006. They also included, for illustrative purposes only, transitional protections for those existing scheme members who would otherwise have satisfied the 85 year rule before 2013. All other things being equal, so long as the cost of any transitional protections was no more expensive than these protections, there would be no additional cost to be taken into account.

12. The covering letter to the statutory consultation made clear that, as long as any alternative proposals were affordable and could be legally provided, consideration would be given to them as part of the consultation process. The members of the Tri-partite Committee were specifically charged to come forward with such alternative proposals.

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they are based on a) 50% of Scheme members taking an increased lump sum of the maximum 25% of the capital value of their benefits, and 50% of Scheme members taking the same lump sum as they would currently receive of three times their pension; and b) a commutation rate of 12:1 (meaning that for every £1 of pension foregone the Scheme member would receive £12 of tax-free lump sum).

13. To assist in this process, ODPM commissioned GAD to cost a number of alternative scenarios (as discussed in Annex H):

   - No protection
     This would generate a saving of some £1 billion over the eight years from 2005 to 2013, because the cost of the 2013 protections had already been assumed at the 2004 valuations.

   - Additional protection until 2008 for all existing scheme members
     This would cost just over £½ billion in addition to the cost of the 2013 protections assumed at the 2004 valuations.

   - Lifetime protections for existing scheme members
     This would cost around £5 billion in addition to the cost of the 2013 protections assumed at the 2004 valuations.

   - Extension of the 2013 protections until 2018
     This would cost around £1 billion in addition to the cost of the 2013 protections assumed at the 2004 valuations.

14. These options were circulated to members of the Tripartite Committee and other LGPS interests on 3 February 2006. The costing of lifetime protection was discussed in much detail, leading up to the 14 March Tripartite Committee meeting, despite no party having put forward a proposals for how such protections could be legally objectively justified.

Conclusions

15. Much open and considered discussion took place between ODPM, the local government employers and the trades unions together with their associated actuarial advisors over a number of months. GAD's costings were shared with the Tripartite Committee members and other LGPS interests, openly discussed and their assumptions reviewed. The notes of these meetings are available on the ODPM LGPS website.

16. GAD is acknowledged to be an expert source of independent actuarial advice for public service pension schemes. The discussions held between GAD and the actuarial advisors for other LGPS stakeholders were productive in agreeing appropriate revisions to estimates and assumptions, and, at the same time, in establishing key differences in the respective position of the 'clients'.

17. All the information and data produced in respect of this current amendment exercise has now been assessed and reviewed in the preparation of final advice to Ministers.

ANNEX H

Analysis of the costs[9] and benefits of each option identified

Ensuring ongoing solvency of the Scheme following the revocation of the Amendment No.2 Regulations 2004

Option 1 - Do nothing

1. It was made clear, as part of the consultation material on regulations to revoke the No.2 Regulations, that any savings foregone through revocation would need to be found by other means. No new money from government or local authorities would be made available.

2. As the Amendment Regulations allowed for interim valuations, it could be the case that the revised certificate would show that, as a result of investments performing better than expected for example, the identified cost of revocation had been mitigated. It could also be the case that drops in yields, or any further market reductions, would offset the better performance of equities since the last valuation. It would not be prudent to rely on the increased performance of investments over and above assumptions in an environment where investments can down as well as up.

3. Furthermore, the Government made a clear commitment to Parliament that further regulations will be introduced to ensure the cost pressures arising from the revocation are met. Simply relying in an imprudent manner on increased performance of investments would not ensure the costs have been met in the long term, and therefore would not meet the Government's commitment to Parliament.

Economic

4. **Benefits** – None

5. **Costs** –£435 million for LGPS funds in England and Wales for 2005/06, or £650 million for the 18 month period from 1 April 2005 to 1 October 2006. In the longer term the retention of the 85 year rule would continue to cost the scheme some 2% -2.5% of pensionable payroll per year.

Environmental

6. There are no environmental benefits or costs to this proposal.

Social

7. **Benefits** - The trades unions and many Scheme members would prefer, were this to be possible, to maintain the status quo and not to change the Scheme for existing members. This view has been borne out in the responses to the statutory consultation exercise.

8. **Costs** - Not taking any action to mitigate the current cost pressures facing the Scheme would be likely to be criticised by local authorities and taxpayers generally. Furthermore, not taking the cost pressures facing the Scheme into account now could jeopardise the long term future of the Scheme. The Government has a statutory obligation to ensure the Scheme's affordability, viability and acceptability, and to have regard to issues of fairness in the balance between taxpayers and members benefits.

Option2 - Increase tax-free lump sum

9. Scheme members currently receive a pension payable per annum equal to their final salary x number of years contributions x 1/80. Additionally they receive a tax-free lump sum on retirement of 3 times the amount of their final pension. From 6 April 2006, HM Revenue and Customs (HMRC) tax simplification will permit Scheme members to take up to 25% of the capital value of their benefits as a tax-free lump sum, when they retire.

10. Where Scheme members chose to take more, any increase, above the three times amount currently provided for, would be paid for by the Scheme member "commuting" part of their final pension, i.e.

[9] The development of the actuarial costings referred to here and throughout the RIA is outlined in Annex G.

swapping pension for tax-free cash. Any subsequent survivor pension would be calculated on the pension calculated prior to any commutation. This flexibility is explained in more detail in Annex C.

Economic

11. **Benefits** –
- a saving to the Scheme of around £1¼ billion in relation to accrued service of existing scheme members;
- a saving of 1/2% of pensionable payroll in relation to future service of existing scheme members; and
- a saving of 1/3% of pensionable payroll in relation to future service of new scheme members.

12. **Costs -** There might be residual costs to Government by way of lost tax receipts and possible higher take-up of social security benefits. These issues would have been considered by HMRC as part of the introduction of a new tax regime.

Environmental Benefits/Costs

13. There are no environmental benefits or costs to this proposal.

Social

14. **Benefits** - Allows scheme members the choice to access more tax-free cash on retirement, which is likely to be welcomed by the Scheme member. This proposal received significant support from respondees to the consultation on the draft Regulations.

15. **Costs** - It might not be in the best long term financial interests of some scheme members to give up ("commute") part of their pension to obtain a tax-free lump sum above the current 3/80ths permitted. Scheme members would need to obtain professional financial advice on the best course of action, based on their own personal circumstances, before reaching a decision.

Option 3 - Increase employee contributions

16. Scheme members, post 1998, currently pay a 6% contribution towards their pension fund. A diminishing number of manual workers who were members of the Scheme prior to 1988 pay 5%. The average employee contribution rate across the Scheme is some 5.8%. One option for meeting the cost pressures arising from the Scheme would be to increase all Scheme member contributions by 1%.

Economic

17. **Benefits** - A 1% increase in employee contributions for just the two years 2006/07 and 2007/08 might generate just over £500 million.[10] This would pay for the cost of revocation for 2005/06 (some £340-390 million) and is close to but is not as great as the cost of revocation for the 18 months from 1 April 2005 until 1 October 2006 (£520–590 billion).

18. Some individuals responding to the consultation were in favour of an increase in employee contribution rates, in order to secure the current benefit package, rather than to meet revocation costs. However, this was not based on an understanding of by how much contributions would have to increase.

19. **Costs -** An increase in the employee contribution rate could lead to increased pay demands, which could ultimately increase pension liabilities rather than control them, due to the cost pressures falling on local authority employers. A higher contribution rate could also make the LGPS seem less attractive to eligible members and might lead to some increased numbers opting out of the scheme.

20. This could therefore potentially lead to a decrease in total employee contributions received by the Scheme rather than an increase. If it is the younger members who opt out, this could change the profile of the Scheme and increase the employer contribution rate (expressed as a percentage of pensionable pay) – albeit that the increased rate would be applied to a smaller overall pensionable payroll.

[10]This is based on a pensionable payroll figure of £25 billion for 2004/05.

21. Furthermore the increase in the contribution rate only recoups the cost of revocation if the 85 year rule is removed from April 2006. It would not cover the extra cost incurred between April and October 2006, if the rule is not removed until 1 October 2006.

Environmental

22. There are no environmental benefits or costs to this proposal

Social

23. **Benefits** - None

24. **Costs** - The increase may be seen as poorly targeted as it would affect all Scheme members, not just those entitled to retire under the 85 year rule. Therefore some Scheme members would be paying for a benefit that they would not be able to receive. The increase could also result in a lower take-up of the Scheme at a time when measures to increase member take-up are being considered.

Alternative options considered

Binding pay deals

25. This would prevent high pay increases which place pressure on the pension fund. A variation of this would be the option to control or reduce the amount of pay which is pensionable. Pay rises could also be negotiated separately from pensionable pay rises, so that, for example, pensionable pay might rise each year by 1% less than actual pay.

26. The impact of introducing binding pay restraints, or a variation thereof, would depend on when this was introduced and for how long. It would be almost inevitable that there would be catch-up in the future and so any saving would be unlikely to be realised in the long term. The effect of pay catching up in a final salary pension arrangement are highly significant in terms of increased liabilities, since it would effectively revalue all the past accrued periods of membership..

27. This option was rejected as the potential long term benefits could not be guaranteed.

Move to Career Average Re-valued Earnings (CARE) Scheme

28. A CARE scheme could help control future cost volatility and could be designed to deliver broadly the same expected employer cost as a final salary scheme. The saving arises from the difference in the expected rate or revaluation of each year's benefits. This could be more attractive than final salary designs to those with modest pay growth/promotion expectations.

29. One possible variation on this option is that CARE could be offered as the *default* options for certain groups of staff e.g. part-timers or those whose earnings were below a certain level. All members could be allowed to opt into the other design (i.e. from CARE to final salary and vice versa) at the start of their career and possibly at points in the future (for subsequent benefit accrual).

30. A CARE scheme would reduce the risk of future cost volatility due to pay settlements and in some respects may prove potentially cheaper to administer in the long term. It could provide better pension for low paid/part-time workers and more accurately reflect the needs of the local government workforce (as identified in the *Review of Demographic Patterns* report, by Hymans Robertson). It is not known what accrual and revaluation rates would be acceptable to trades unions and/or employers. It could also exacerbate work place tensions as it would require a cultural shift from the perceived "gold standard" of the final salary pension Scheme.

31. This option was rejected, at this point in time, as it would require a major change to the Scheme which would not be possible by the autumn. It is likely to be considered further in discussions on the long term reform of the Scheme.

Change to ill-health/early retirement packages

32. Current practice permits local authorities to enhance a Scheme member's pension, by up to 10 years or such as would give the member 40 year's service overall. This particularly applies where scheme members retire early or on grounds of ill-health. Savings could be achieved by amending the amount local authorities can enhance by, or criteria by which they set their standard. This could result in better pension provision for some of those permanently retired on ill-health grounds

33. For ill-health retirements, a two tier system could be introduced for Scheme members who are able to work again but not necessarily in their previous local government post. This could reduce instances of Scheme members retiring on ill-health grounds and then returning to work in another area (local government, public service or elsewhere) whilst still receiving a full occupational pension from local government. It could also reduce the long term liabilities facing the Scheme by reducing the number of fully enhanced ill-health/early retirement cases.

34. This option was rejected as it would require a major change to the Scheme which would not be possible by the autumn. It is likely to be considered further in discussions on the long term reform of the Scheme and a new-look benefit package for 2008.

Incentives to remain in employment

35. The later members delay their retirement beyond the earliest age from which they can take their benefits unreduced (and as of right), the greater the cost saving to the Scheme. There would be a need in designing the benefits being offered to members to delay their retirement, to ensure they do not fall under the preservation requirements or fall foul of age discrimination.

36. The wider picture also needs to be taken into account. Encouraging scheme members to remain in employment will become increasingly important as the ratio of working age population to pensioner population decreases in the coming years (as identified in the *Review of Demographic Patterns* report, by Hymans Robertson).

37. This option was rejected as it would require a major change to the Scheme and to employment culture amongst LGPS employers, which would not be possible by the autumn. It is likely to be considered further in discussions on the long term reform of the Scheme and a new-look benefit package for 2008.

The extent of the continuation of the 85 year rule

Option 4: Do nothing

38. The Council Directive 2000/78/EC establishes a general framework for equal treatment in employment and occupation. To implement the Directive in the field of employment law the Department of Trade and Industry consulted on draft Employment Equality (Age) Regulations 2006 which come into effect from 1 October 2006.

39. Parallel implementation steps must therefore be taken with regard to the LGPS where necessary by no later than 1 October 2006. The Government's view is that the 85 year rule is age discriminatory (as demonstrated in Annex B) and therefore any retention of the provision beyond this date must be objectively justified. The Government does not believe there is any objective justification for retaining the provision in the Scheme, although some transitional protections could be justified.

Economic

40. **Benefits –** None.

41. **Costs –**The 2004 valuations assumed the removal of the rule from 1 April 2005 (notwithstanding some transitional protection for those retiring under the rule of 85 before 2013). If its removal was not forthcoming, neither would the anticipated savings (some 2-2.5% p.a.).

42. In line with the Government's commitment to Parliament, measures would need to be introduced to ensure this increased cost is met. The measure identified for meeting the cost of revocation would need to ensure that such further costs would not fall to the taxpayer. The measure identified and agreed by the members of the Tripartite Committee ("commutation") would not be sufficient to do this.

Environmental Benefits/Costs

43. There are no environmental benefits or costs to this proposal.

Social

44. **Benefits -** Those scheme members who satisfy the 85 year rule before 65 would continue to be eligible to receive an unreduced pension from 60 (or 50 with employer consent).

45. However, this early retirement mechanism is discriminatory and therefore should not be judged as a benefit, even though some individuals do gain from it. Even so, almost all individuals responding to the consultation were in favour of retaining the 85 year rule, at least for existing scheme members.

46. **Costs –** The 85 year rule is directly age-discriminatory and also discriminates indirectly against women, who tend to join the scheme later in life and thus accrue shorter periods of service. Retaining it would therefore continue that discrimination and would continue to benefit long serving, career local authority workers at the expense of other Scheme members.

47. If the 85 year rule were not to be removed from 1 October, the Government would be at risk of challenge from relevant parties who might continue to experience differential treatment on grounds of age, or of facing infraction proceedings for failing to implement the Directive properly.

Option 5: Remove the 85 year rule from 1 October 2006 for all scheme members

48. As discussed above, 1 October 2006 is the latest date by which the LGPS must be compliant, as the domestic legislation applies from this common commencement date. This would mean that the cost pressures generated by the revocation of the No.2 Regulations would be limited from 1 April 2005 to 1 October 2006.

<u>Economic</u>

49. **Benefits –** In the long-term, this would fulfil the fund actuaries' assumptions at the 2004 valuations that the rule be removed, saving some 2-2.5% of payroll.

50. The removal of the 85 year rule could also potentially increase the proportion of LGPS members aged 50 plus who are economically active.

51. **Costs –** The cost of revocation, for the 18 month period 1 April 2005 to 1 October 2006 would be some £650 million.

<u>Environmental Benefits/Costs</u>

52. There are no environmental benefits or costs to this proposal.

<u>Social</u>

53. **Benefits –** The 85 year rule discriminates directly on grounds of age and indirectly on grounds of gender. Removing it would therefore be a significant step towards equality-proofing the scheme.

54. As part of the Government's intention since July 2003 that up to 50% of the savings achieved from the removal of the 85 year rule could be recycled into the Scheme. Removing the rule would enable consideration to be given to this recycling of savings back into a new-look Scheme from 2008 that is affordable and legal.

55. **Costs -** Some scheme members, who retire early on a reduced pension, when otherwise they would have retired on an unreduced pension under the 85 year rule, might find they were now entitled to pension credit and other benefits, due to the reduction in overall income. Alternatively they might stay economically active, earn more and therefore continue paying higher taxes and National Insurance contributions, and retire on a higher pension.

56. Almost all individuals responding to the consultation were in favour of retaining the 85 year rule, at least for existing scheme members, even though it is discriminatory.

<u>Alternative options considered</u>

Remove the 85 year rule from 1 April 2006 for new scheme members and from 1 October 2006 for existing scheme members.

57. This would ensure the LGPS would be compliant by 1 October and would generate some marginal savings when compared to the cost of Option 5.

58. However, the draft proposals consulted on in December 2005 removed the 85 year rule from 1 October. Employers and employees may therefore have an arguably legitimate expectation that the 85 year rule would be removed from 1 October, as this was the proposal consulted on in the draft regulations. Moving the removal forward to 1 April may cause some difficulties in terms of recruitment and administration. This option was therefore rejected.

Change from a normal retirement age (NRA) of 65 to NRA 60 for existing scheme members

59. The 85 year rule is a provision which allows scheme members to retire between 60 and 65 on an unreduced pension if their age plus qualifying service equals 85. It could be replaced by a move from NRA 65 to NRA 60 for existing scheme members, which would remove the age-discriminatory aspects of early retirement in the LGPS while still allowing members to retire at 60 on an unreduced pension.

60. However, this option was rejected on grounds of cost, being more expensive than simply retaining the rule of 85, and because it runs against wider government policy to move to a retirement age of 65 in all public service pension schemes and against the approach being taken by DTI in employment law which has been fully supported.

Transitional protections for existing scheme members

Option 6: Do nothing

61. It has been argued that providing no protection would be the most equitable way to proceed, given that the 85 year rule is age discriminatory.

Economic

62. **Benefits –** The 2013 protections were assumed at the 2004 valuations alongside the removal of the 85 year rule from 1 April 2005. Rescinding on these protections could generate savings to the funds of close to £1 billion (this being the cost of the 2013 protections from 1 April 2005 to 31 March 2013).

63. **Costs –** None.

Environmental Benefits/Costs

64. There are no environmental benefits or costs to this proposal.

Social

65. **Benefits -** The 85 year rule discriminates directly on grounds of age and indirectly on grounds of gender. Transitional protection arrangements require the objective justification of the continuation of a discriminatory measure. Therefore, providing no protections could be the most equitable solution moving forward.

66. **Costs –** However, the vast majority of individuals responding to the consultation were in favour of changes applying to new scheme members only. Not proceeding with the 2013 protections could also be seen to be rescinding on existing scheme members legitimate expectation that these protections would be implemented.

Option 7: Protect those who would otherwise have satisfied the 85 year rule at age 60 or above by 2013

67. Even though the 85 year rule is age discriminatory, articles 2.2 and 6.2 of Directive 2000/78/EC permit Member States to objectively justify continuation of such discrimination to achieve a legitimate aim. It is considered that the protection of those scheme members closest to retirement who do not have time to make alternative arrangements to off-set any reduction in their benefits as a result of the removal of the 85 year rule is objectively justified.

<u>Economic</u>

68. **Benefits –** None – these protections were assumed at the 2004 valuations and so are already reflected in employer contribution rates for 2005/06 – 2007/08.

69. **Costs -** None – these protections were assumed at the 2004 valuations and so are already reflected in employer contribution rates for 2005/06 – 2007/08.

<u>Environmental Benefits/Costs</u>

70. There are no environmental benefits or costs to this proposal.

<u>Social</u>

71. **Benefits -** To proceed with these protections would, broadly speaking, ensure no change (all other things being equal) to the benefits of existing scheme members currently within seven years of retirement and would fulfil their arguably legitimate expectation that these protections would be implemented.

72. **Costs –** The 85 year rule discriminates directly on grounds of age and indirectly on grounds of gender. Transitional protection arrangements require the continuation of a discriminatory measure and must be objectively justified.

73. However, the vast majority of individuals responding to the consultation were in favour of changes applying to new scheme members only, even though the Government's view is that this cannot be objectively justified.

Option 8: Protect all existing scheme members until 31 March 2008

74. Even though the 85 year rule is age discriminatory, articles 2.2 and 6.2 of Directive 2000/78/EC permit Member States to objectively justify continuation of such discrimination to achieve a legitimate aim. It is considered that this could be objectively justified, on the grounds that it would provide existing scheme members with a smoother transition to the new-look scheme to be implemented in April 2008.

<u>Economic</u>

75. **Benefits –** None.

76. **Costs –** Just over an additional £½ billion on top of the cost of the 2013 protections as assumed at the 2004 fund valuations. This would mean there would be less money available in the new-look scheme for benefit improvements for all scheme members.

<u>Environmental Benefits/Costs</u>

77. There are no environmental benefits or costs to this proposal.

<u>Social</u>

78. **Benefits –** This would effectively provide existing scheme members (i.e. all scheme members in active service immediately prior to the date at which the 85 year rule is removed) with another 18 months of service under the 85 year rule. Any actuarial reduction would therefore be in relation to future service accrued after April 2008 rather than the date at which the 85 year rule is removed.

79. In addition, these protections could be perceived to be more equitable than Options 8 and 9, as they would allow an extra 18 months of accrual under the 85 year rule for all existing scheme members, rather than just those who would stand to benefit from the 85 year rule anyway before 2013.

80. **Costs -** The 85 year rule discriminates directly on grounds of age and indirectly on grounds of gender. Transitional protection arrangements require the continuation of a discriminatory measure and must be objectively justified.

81. However, the vast majority of individuals responding to the consultation were in favour of changes applying to new scheme members only, even though the Government's view is that this cannot be objectively justified.

Option 9: Protect those who would otherwise have satisfied the 85 year rule before 2018

82. The Government's view is that extending the 2013 protections until 2018 could also be justified on the same grounds as Option 7.

Economic

83. **Benefits –** None.

84. **Costs –** Around an additional £1 billion on top of the cost of the 2013 protections as assumed at the 2004 fund valuations. This would mean there would be less money available in the new-look scheme for benefit improvements for all scheme members.

Environmental Benefits/Costs

85. There are no environmental benefits or costs to this proposal.

Social

86. **Benefits –** This would provide protection for a larger group of scheme members – all those within 12 years of retirement rather than seven.

87. **Costs -** The 85 year rule discriminates directly on grounds of age and indirectly on grounds of gender. Transitional protection arrangements require the continuation of a discriminatory measure and must be objectively justified.

88. However, the vast majority of individuals responding to the consultation were in favour of changes applying to new scheme members only, even though the Government's view is that this cannot be objectively justified.

Option 10: Allow buy-back of any actuarial reduction resulting from the removal of the 85 year rule

89. This would allow scheme members the option of making extra contributions in order to "make good" any actuarial reduction that might otherwise result following the removal of the 85 year rule, should a scheme member wish to retire before 65.

Economic

90. **Benefits –** At a scheme level, the actuarial buy-back factors to be provided by GAD would be cost-neutral to the Scheme to reflect the cost of the extra pension rights accruing.

91. **Costs –** None – cost neutral.

Environmental Benefits/Costs

92. There are no environmental benefits or costs to this proposal.

Social

93. **Benefits –** Scheme members would be able to make additional contributions to enable them to retire early on an unreduced pension if this is what they still wished to do.

94. This option has been proposed in light of requests from individual scheme members, and was overwhelmingly supported by respondees to the consultation on the draft Regulations, even though to a certain extent the current Scheme regulations already allow for this by means of AVC, Shared Cost AVC and augmentation provisions.

95. **Costs –** The actuarial buy-back factors might seem unattractive in comparison to the contributions scheme members are accustomed to paying, as they would reflect the actual cost of the pension rights accruing to the scheme in relation to that individual. Standard employee contribution rates are fixed and employers currently bear over 2/3rds of the cost of their pension liabilities. Those scheme members with little disposable income might therefore be unable or unwilling to take up such an option.

96. The actuarial reduction factors are reviewed from time to time by the Government Actuary's Department (GAD) in the light of changes to the economic and demographic environment within which the scheme operates. It is intended to commission a review of the current factors from GAD alongside the current amendments being made to the scheme.

Option 11: Flexible retirement

97. The Finance Act 2004 established a new tax regime effective from 6 April 2006 which allows a pension to come into payment from a pension scheme while the scheme member is still employed. This flexibility allows a new approach to those many scheme members who do not wish to continue working in the same way as they age.

98. Instead of retiring completely at earliest possible opportunity a pension could be drawn providing the scheme member takes either a reduction in hours or grade. Such steps would be subject to mutual agreement between the employee and employer from age 50, subject to appropriate actuarial reductions and strain costs (the extra liability falling to an employer as a result of pension coming into payment early. There was much support for this proposal from respondees to the consultation on the draft Regulations.

<u>Economic</u>

99. **Benefits –** It is difficult to foresee precisely at this time how flexible retirement might effect the cost of the LGPS overall. However, it is possible that the state would benefit from employees remaining in work longer due to the higher tax take and delay in drawing state benefits associated with retirement. The introduction of flexible retirement provisions could also potentially increase the proportion of LGPS members aged 50 plus who are economically active.

100. This may also allow employers flexibility to manage their workforce and costs, and is the first step towards a pension scheme which allows employees to retire gradually according to their needs and skills.

101. **Costs –** It is difficult to foresee precisely at this time how flexible retirement might effect the cost of the LGPS overall. It might be that the forecast savings in association with the provision to allow increased commutation of pension to lump sum would be reduced by these first steps towards flexible retirement. This might lead to extra cost pressures falling to the scheme that would need to be recouped by other means, in order to fulfil the Government's commitment to Parliament that revocation costs would not fall to local or national taxpayers.

102. Development of proposals for a new-look scheme is underway and the next fund valuation takes place in 2007. In the context of these reviews, it would be reasonable to reconsider the effect of such adjustments to the scheme cost once there is some evidential experience available.

<u>Environmental Benefits/Costs</u>

103. There are no environmental benefits or costs to this proposal.

<u>Social</u>

104. **Benefits –** As mentioned above, it would be likely that the introduction of such flexibilities would encourage scheme members to remain in work later in life, and therefore that LGPS members would

continue to be economically active and on becoming pensioners would be better able to provide sufficiently for their retirement.

105. Scheme members who work beyond the scheme's Normal Retirement Age (NRA) would be likely to increase scheme funds because of the added investment return and interest resulting from the delayed payment of liabilities. The scheme member would benefit from an uplift of their pension benefits to reflect the shorter payment period.

106. The employer would be able to retain employees in work longer and manage the needs and skills of their older workers more effectively and productively.

107. **Costs –** None.

Alternative options considered

Protect all existing scheme members until they leave the LGPS ("lifetime protections")

108. The Government's view is that lifetime protections for existing scheme members cannot be objectively justified as this would require the retention of a discriminatory provision for potentially some 40 years. Additionally, GAD have estimated the capital cost of such a provision to be around £5 billion. This Option was therefore rejected.

109. However, individual respondees to the consultation on the draft Regulations were almost totally in favour of such an approach, despite its age-discriminatory nature.